No. 93-572

In The

Supreme Court of the United States

October Term, 1993

FRUEHAUF CORPORATION,

Petitioner,

vs.

C. KENNETH STILL, TRUSTEE FOR SOUTHWEST EQUIPMENT RENTAL, INC., d/b/a SOUTHWEST MOTOR FREIGHT,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

The Respondent, C. Kenneth Still, Trustee (hereinafter referred to as "Trustee"), for Southwest Equipment Rental, Inc. d/b/a Southwest Motor Freight (hereinafter referred to as "Southwest"), respectfully submits that several significant misstatements of fact have been made by Petitioner, in its Petition for Writ of Certiorari, in the Statement of the Case section, which have a direct hearing on the issues Petitioner seeks to have this Court review.

On page 4 of its Petition, first full paragraph, Petitioner states, "Being delinquent in the making of its payments was how Southwest conducted its business during this period." However, there is no finding of fact in any of the lower courts' decisions which were set forth by the Petitioner in the Appendix to their Petition, that Southwest generally conducted its business during the one year preference period by being delinquent in the making of its payments. The only finding remotely related to such a statement was that all payments made by Southwest to Fruenhauf were delinquent. This is clearly a misstatement of fact which has a direct bearing on the issues regarding 11 U.S.C. § 547(c).

Another significant misstatement of fact is the very next statement made by Petitioner on page 4 which states, "The record reflects that nearly every payment Southwest made on any of its obligations while the Lease was in effect were made over thirty (30) days late." In fact, however, as the Bankruptcy Court's Memorandum shows, based upon a schedule provided by Petitioner to the Bankruptcy Court during the trial of the case, of the payments made within the preference period, approximately twenty-seven (27) were made over 30 days late. While such number may be a "majority", it certainly is not "nearly every payment" and is again a misstatement of fact made by Petitioner which goes directly to the issues before this Court.

Petitioner further incorrectly stated at page 4, last sentence in the second full paragraph, "Various witnesses testified that late payments occurred in the common carrier industry and that between two (2) and twenty (20) percent (depending on the witness) of all payments made on trailer leases they were familiar with were between thirty and sixty days late." However, in fact, the witnesses that testified on behalf of Petitioner at the trial of this case testified that only two percent (2%) to ten percent (10%) were delinquent between 30 and 60 days late. The 20% figure was based upon the testimony of one of Petitioner's witnesses as to the

percentage of accounts which were one (1) to thirty (30) days past due as set forth in the Bankruptcy Court's Memorandum. Again, Petitioner has made a significant misstatement of fact which goes directly to the issues regarding 11 U.S.C. § 547(c).

REASONS FOR DENYING THE WRIT

I.

11 U.S.C. § 547(c)(2)(C) REFERS TO ORDINARY BUSINESS TERMS WITHIN THE INDUSTRY IN QUESTION AND THERE IS NO CONFLICT OF AUTHORITY AMONG THE CIRCUITS OR RECENT LOWER COURT DECISIONS ON THIS ISSUE.

The first question Petitioner would like for the Supreme Court to review is whether the "ordinary business terms" test of 11 U.S.C. § 547(c)(2)(C) relate to "ordinary business terms" between the parties or to "ordinary business terms" in the industry in question. Petitioner contends that there is a split of authority among the lower federal courts and bankruptcy courts on the issue and that this is an important question of law that should be settled by this Court.

Respondent submits that there is no conflict of decisions among the courts of appeal on this issue nor is there a conflict among the most recent decisions from lower federal courts across the country in deciding this issue. Petitioner states that the district court relied upon the Sixth Circuit decisions of *In re Fulghum Construction Corp.*, 872 F.2d 739 (6th Cir. 1989) and *In re Yurika Foods Corp.*, 888 F.2d 42 (6th Cir. 1989) and upon other bankruptcy court decisions in ruling that 11 U.S.C. § 547(c)(2)(C) meant that the "ordinary business terms between the parties" was the requirement of that section rather than a determination of the "ordinary business terms in the industry". However, upon a

reading of the cases cited by Petitioner and relied upon by the district court, it is clear that these cases clearly contemplated that the third prong of § 547(c)(2) was directed to industry practice. The Sixth Circuit in *In re Fulghum,* in a footnote, after making a determination as to the ordinary course of dealings between the parties under § 547(c)(2)(B) clearly recognized that "Consideration of the practices of the parties might not conclude the § 547(c)(2) analysis; industry practice might be relevant to the § 547(c)(2)(C) element of "ordinary business terms". 872 F.2d at 743, n. 5. The *Fulghum* court then cited *In re Magic Circle Energy Corp.,* 64 B.R. 269, 274 (Bankr. W.D. Okla. 1986), for the above quoted proposition. Similarly, the Sixth Circuit in *In re Yurika, supra,* clearly recognized the need to examine industry standards in addition to the parties' prior dealings and in fact found that the payments at issue in that case were within the ordinary course of business between the parties *and* within the ordinary business terms within the industry. 888 F.2d 42, 45 (6th Cir. 1989).

Most recently, the Sixth Circuit, in *Logan v. Basic Distribution Corporation, (In re Fred Hawes Organization, Inc.),* 957 F.2d 239 (6th Cir. 1992), *rehearing denied,* (6th Cir. 1992), succinctly and without question made it clear that all elements of § 547(c)(2) must be established if avoidance by the Trustee is to be defeated. As stated by the Sixth Circuit in the decision from which the Petitioner seeks review, *Logan* does not conflict in any way with *Fulghum* or *Yurika.*

Petitioner cites several lower bankruptcy court decisions as support for the district court's conclusion that the "ordinary business terms" requirement of § 547(c)(2)(C) applies only to what is ordinary between the parties. However, upon a careful review of the most recent bankruptcy, district court and court of appeals decisions across the country, the courts deciding this issue are in complete accord with *Logan* and specifically state that § 547(c)(2)(C) requires a review of what is ordinary within the

industry. *WJM, Inc. v. Massachusetts Department of Public Welfare,* 840 F.2d 996 (1st Cir. 1988); *In re Tolona Pizza Products Corporation,* 1993 W.L. 315560 (7th Cir. 1993); *In re Food Catering and Housing, Inc.,* 971 F.2d 396 (9th Cir. 1992); *In re Hill's Oil and Transfer, Inc.,* 143 B.R. 207 (Bankr. C.D. Ill. 1992); *In re Ajayem Lumber Corp.,* 143 B.R. 813 (Bankr. S.D.N.Y. 1992); *In re Molded Acoustical Products, Inc.,* 150 B.R. 608 (D.C.E.D. Pa. 1993); *In re USA Inns of Eureka Springs, Arkansas, Inc.,* 151 B.R. 486 (Bankr. W.D. Ark. 1992).

Clearly, therefore there is no current dispute among the courts of appeal or the most recent lower court decisions on this issue as all courts are recognizing that § 547(c)(2) has *three* separate elements that must be met and the third element is that of an industry standard determination.

From a practical standpoint and a simple reading of the statute it is clear that Congress intended there to be three separate elements to be met in defeating a preference action based upon ordinary course and that the third element required more than a determination of what is ordinary between the parties as § 547(c)(2)(B) already set forth that requirement. The Ninth Circuit Bankruptcy Appellate Panel in the case of *In re Loretto Winery,* 107 B.R. 707 (9th Cir. BAP 1989) said it best when it stated:

> It was the conclusion of the trial court that the third of these conditions, subparagraph (C), embodied an objective standard to be shown by the custom in the industry in which the transferee and debtor are engaged. We agree, for to graft upon the relevant terms anything but an objective yardstick would either ignore the operative nomenclature altogether, thereby making it a nullity or interpret it in a manner

> which duplicates the requirement of subparagraph (B), thereby making it superfluous. (Citation omitted.) Such a construction would run contrary to settled principles of construction by impermissibly rendering the statue inoperative or superfluous and by failing to give effect to all the words employed by Congress.

It is clear from reading 11 U.S.C. § 547(c)(2) that more than just a determination of what is ordinary between the parties is required under § 547(c)(2)(C) and the courts faced with the issue are equally as clear.

Therefore, this is an issue that has been resolved and does not need Supreme Court review.

II.

THE FOCUS OF "ORDINARY BUSINESS TERMS" UNDER § 547(c)(2)(C) IS UPON WHETHER THE SUBJECT TRANSFER IS ORDINARY IN RELATION TO THE PREVAILING INDUSTRY STANDARDS.

The second issue the Petitioner would like for the Supreme Court to review is whether the focus of § 547(c)(2)(C) should be upon, (1) "were the terms employed in and governing the transaction as a whole" customary business terms, or (2) whether the "practice of making late payments is an 'industry standard' practice."

The Petitioner relies heavily upon *In re Magic Circle Energy Corp., supra,* for the proposition that "ordinary business terms" as set forth in § 547(c)(2)(C) requires a determination that the "transaction as a whole" was within the ordinary business terms

within the given industry and not whether the payment or transfer was within the ordinary business terms of the industry. However, the court in *In re Magic Circle Energy Corp., supra,* after setting forth a subjective requirement as to the determination of what is "ordinary as between the debtor and creditor," clearly stated, "The court is further required to view the subject transaction from an objective viewpoint: whether the subject transfer was made according to common industry practice. 11 U.S.C. § 547(c)(2)(C)." There is no doubt that the court in *In re Magic Circle Energy Corp.* intended the focus to be upon "the subject transfer" in determining whether it was within ordinary business terms within the industry. Similarly, the courts of appeal faced with the issue regarding the third requirement of § 547(c)(2)(C) and lower courts throughout the country recently faced with this issue all agree that it is the "payment" or "transfer" at issue that must be ordinary in relation to prevailing industry standards. *WJM, Inc. v. Massachusetts Department of Public Welfare,* 840 F.2d 996 (1st Cir. 1988); *Logan v. Basic Distribution Corporation (In re Fred Hawes Organization, Inc.),* 957 F.2d 239 (6th Cir. 1992), *rehearing denied,* (6th Cir. 1992); *In re Tolona Pizza Products Corporation,* 1993 W.L. 315560 (7th Cir. 1993); *In re Food Catering and Housing, Inc.,* 971 F.2d 396 (9th Cir. 1992); *In re Ajayem Lumber Corp.,* 145 B.R. 813 (Bankr. S.D.N.Y. 1992); *In re Hill's Oil and Transfer, Inc.,* 143 B.R. 207 (Bankr. C.D. Ill. 1992); *In re USA Inns of Eureka Springs, Arkansas, Inc.,* 151 B.R. 486 (Bankr. W.D. Ark. 1992). Clearly, the issue is not subject to quite the conflicting decisions as Petitioner would have this Court believe.

Within this issue Petitioner makes an argument on page 10, last sentence of the first paragraph of its Petition that, "It is difficult to imagine that anyone will ever be able to prove that it is a standard practice of any industry to permit late payments as an ordinary and customary practice." However, that argument is entirely without merit as evidenced by the case of *In re Ajayem Lumber Corp.,* 145 B.R. 813 (Bankr. S.D.N.Y. 1992), where the court found that late

payments within a certain range was normal and was the industry practice within the industry in question. In addition, the Sixth Circuit in the court of *In re Yurika Foods Corp., supra,* also found that late payments were customary in that particular industry. Clearly, Petitioner's argument must fail.

Based upon the foregoing, the issue which the Petitioner seeks review by the Supreme Court is clearly not in need of review nor is it an important question of federal law which should be resolved.

III.

LATE PAYMENT MAY CONSTITUTE A PREFERENTIAL TRANSFER WITH OR WITHOUT UNUSUAL COLLECTION EFFORTS.

The third issue Petitioner would like for the Supreme Court to review is whether a creditor which has not exerted unusual collection efforts, and has assisted the debtor in staying in business by continuing to accept late payments, should lose the "ordinary course of business" defense simply because payments came slightly later during the preference period.

Again Petitioner contends that the above-stated issue has been the subject of conflicting decisions among bankruptcy courts and other lower federal courts. However, Petitioner can only point to one court of appeals case in support of its position, the case of *In re Colonial Discount Corp.*, 807 F.2d 594 (7th Cir. 1986). However, in the *Colonial Discount Corp.* case, the trustee attempted to avoid the repayment of $50,000 to a creditor based upon the trustee's assertion that the original loan transaction to debtor for which the $50,000 repayment was made was not "ordinary" for the purposes of 11 U.S.C. § 547(c)(2). *Id.* at 600. The $50,000 repayment was found by the court to not constitute a preferential transfer because the original loan transaction was within the ordinary course of

business exception of § 547(c)(2). The holding in the *Colonial Discount Corp.* case was directed to the court's finding as to the original loan transaction and not to the repayment of the $50,000 alleged preferential transfer. The timing of the actual repayment had no bearing whatsoever on the court's finding. Therefore, Petitioner's reliance on *Colonial Discount Corp.* is completely misplaced.

The Petitioner further contends that the case of *In re Magic Circle Energy Corp., supra,* held that, "The purpose of 11 U.S.C. 547 (c) (2) was to protect payments which did not result from unusual debt collection practices," yet cited the exact wording of the court in *In re Magic Circle* which stated, "The purpose of a preference action is to prevent a particular creditor from obtaining more favorable treatment than other creditors." The phrase, "more favorable treatment than other creditors", has no relation to the phase, "unusual debt collection practices", and Petitioner is confusing the issues. Clearly, the purpose of the preference statute, 11 U.S.C. § 547, is to prevent a particular creditor from being preferred by a debtor prior to the bankruptcy of a debtor. The Seventh Circuit, the same circuit that Petitioner cites in support of its theory, in the case of *Tolona Pizza Products Corp., supra,* recently and very aptly explained how and why a late payment may still be considered a preferential transfer to a creditor who accepted late payments from the debtor prior to bankruptcy. The Seventh Circuit in *Tolona* stated,

> It may seem odd that paying a debt late would ever be regarded as a preference to the creditor thus paid belatedly. But it is all relative. A debtor who has entered the preference period — who is therefore only 90 days, or fewer, away from plunging into bankruptcy — is typically unable to pay all his outstanding debts in full as they come due. If he pays one

> and not the others, as happened here, the payment though late is still a preference to that creditor, and is avoidable unless the conditions of § 547 (c) (2) are met . . . The purpose of the preference statute is to prevent the debtor during his slide toward bankruptcy from trying to stave off the evil day by giving preferential treatment to his most importunate creditors, who may sometimes be those who have been waiting longest to be paid. Unless the favoring of particular creditors is outlawed, the mass of creditors of a shaky firm will be nervous, fearing that one or a few of their number are going to walk away with all the firm's assets; and this fear may precipitate debtors into bankruptcy earlier than is socially desirable. *In re Xonics Imaging, Inc., supra,* 837 F.2d at 765; *In re Fred Hawes Organization, Inc., supra,* 957 F.2d at 243 N.5.

Notably, the Seventh Circuit did not make any mention of unusual debt collection practices but merely focused on the clear purpose of the statute, which remains the same as always, to prevent one creditor from being preferred over another prior to the bankruptcy of a debtor. To focus solely on whether or not a creditor employed unusual collection efforts in order to obtain more preferential treatment would leave outstanding those payments or transfers made by a debtor to particular creditors that the debtor felt most inclined to prefer, even with no collection efforts, and such distinction would contravene the clear purpose of the preference provision of the Bankruptcy Code. There is clearly no dispute as to the purpose of the preference statute and where the focus in reviewing preference cases should be placed. Therefore, this matter does not need resolution by the Supreme Court.

CONCLUSION

Based upon the foregoing, the Trustee respectfully submits that the three questions presented by Petitioner in its Petition are issues that are not in dispute among the Circuit Courts of Appeal which have discussed the issues and among the lower federal and bankruptcy courts which have recently determined the issues, and do not represent important questions of law. Therefore, no resolution by the Supreme Court is necessary.

For all the foregoing reasons, Respondent respectfully requests that the Supreme Court deny Petitioner's Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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